NOTES

FINANCING REVOLUTIONS IN MEXICO

It is less than ten years since the days of Diaz, and yet that period already belongs in the ancient history of Mexico. History is made fast in a country that engages in civil war. What happened in the financial life of Mexico during these years of internal strife makes background for the contemporary situation and furnishes also an interesting illustration of what happens everywhere under similar circumstances.[1]

Mexico, it is said, "is a beggar sitting on a bag of gold"—poverty and undeveloped resources, a beggar only half aware of his riches. Petroleum resources, without drills or means of transportation, are worth no more to the native Mexican than they were to the native Pennsylvanian before 1859, merely a liquid with a disagreeable odor. If the beggar would only become law-abiding, keep peace, and pay his debts (or keep up the interest payments), he would find a world ready and anxious to give him financial support, for a consideration.

It looked for a time as if Mexico really wanted to be modernized and be made prosperous. Acting on the advice of creditor nations the gold standard was adopted in 1905, to stimulate trade with those "countries already possessing the gold standard, besides enlarging the investment opportunities of the world."[2] There was also a project for establishing a central bank, built on the European model. During this period Mexico, like other new countries with no investing classes of their own, had two main sources of funds. It could finance the capital requirements of industry either by increasing the note issues and deposits of commercial banks or by appealing to foreign investors. It did both, and business prospered. The notes and deposits of the banks of issue, during the ten prosperous years preceding the panic of 1907, increased approximately threefold. Foreign funds were also available. "Moneys

[1] See *Present and Past Banking in Mexico*, by Walter Flavius McCaleb (Harper & Brothers, 1920. Pp. xxi+269. $2.00), especially chaps. xiii to xvii; also *Industrial Mexico*, by P. Harvey Middleton (Dodd, Mead & Co., 1919. $1.75), especially chaps. x and xi.

[2] From a resolution adopted at a London conference on international exchange which appears "to express the sense of the leading powers concerned" (McCaleb, *op. cit.*, p. 146.)

were flowing into the country from foreign lands in amazing floods. Mining, agriculture, industries, banking—all were being literally swamped. Investors were crying for opportunity to leave their millions in Mexico."[1]

Then all this was cut short by revolution. In the year 1910, the country celebrated the centenary of its independence; "moneys had been lavished in order that fitting emphasis should be laid on the progress of the nation. . . . . But under the outward show was seething discontent; and while still the plaudits were ringing in the streets of the Capital the *grito* of the Revolution had been heard along the Rio Grande."[2]

It is difficult, apparently, to conduct a revolution without inconveniencing someone. In Mexico revolutionary leaders followed one another in quick succession, and having no other visible means of support each in turn balanced his budget by issuing legal-tender paper. But loyal citizens ought not to question the ancient right of the sovereign to debase the currency, especially in time of war. And there were, of course, excellent precedents among civilized nations for financing both revolutions and civil wars by this method. In this respect, Mexico followed the foreign models to excess. All told the various leaders put out over 1,000,000,000 pesos of paper money.

The manner of putting this money into circulation and the consequences which followed are worthy of the tradition.

> Merchants and farmers were compelled at the point of guns to accept it in exchange for goods; and bankers, on pain of jail, were ordered to receive it in liquidation of debts. . . . . Rude soldiers, rifles in hand, proceeded to the market-places, there to buy the things they fancied and to tender "constitutionalist" paper in payment. . . . . The retailer hurried to the wholesale dealer to pay his bills; the dealer raced to the bank to liquidate his obligations; and the bank endeavored in turn to pay back to the people the paper which accumulated in its hands. And all the while the volume of notes endlessly increased, for the Constitutionalists had brought with them their printing presses.[3]

With the force of legal tender behind it, this money soon drove out all other forms. The silver peso and gold had disappeared in November, 1913, when Huerta declared the irredeemable bank notes unlimited legal tender. Within a year even these depreciated bank notes were driven out, and along with them the fractional silver and copper coins, leaving only the revolutionory fiat money in circulation.

[1] *Ibid.*, p. 155. [2] *Ibid.*, p. 200. [3] *Ibid.*, pp. 225–27.

Sir Thomas Gresham, more than three centuries in his grave, must have chuckled to see an alien people so promptly obey his law.

New issues came with the regularity of pay day, and their variety marked the success and failure of different revolutionary leaders. Carranza, at Monclova, emitted what was called the Monclova issue; when he reached Tampico he authorized another issue, named after the Constitutionalist army. This his soldiers carried with them in bundles when they marched into Mexico City.

After a few weeks of experience in the Capital with the issues of the Constitutionalists, Villa and his friends came in and drove Carranza to Vera Cruz. Thereupon effort was made to force the substitution of Villa issues upon the people to the exclusion of those of Carranza. . . . . In the meantime, from Vera Cruz the Constitutionalists kept their presses running, striking off what came to be known as the Vera Cruz issue. And, as things will turn out in that country, ere long they were again established in the Capital, the Villa paper was declared void, and forthwith new millions of Veracruzanas were added to the already congested circulation.[1]

Under such conditions the banks fared badly. When Huerta issued a government loan, the quotas were assigned the various banks with little regard to their reserve status. The officer of one bank went with his attorney to the Minister of Finance "to protest against the allotment fixed on that institution, whereupon he was arrested and the Board of Directors of the bank summoned and compelled then and there to approve the government's measure."[2]

Finally, the Carranza government, under the pretense of protecting the holders of bank notes, took over what remained of the metallic reserves of the banks. In September, 1916, the soldier would no longer accept the paper currency; not even the legal-tender power and the rifle could support its values. Therefore, out of the metallic reserves of the banks, the government paid its monthly deficits for the following year.

This was not done without a show of right. Being Constitutionalists they took their stand, with the aid of counsel, squarely on the Constitution. One seldom finds a more entertaining document than that written by the chief of the department of banking of the Carranza government, setting forth the legal basis for the action.[3] The con-

[1] From a resolution adopted at a London conference on international exchange which appears "to express the sense of the leading powers concerned" (McCaleb, *op. cit.*, p. 229).

[2] *Ibid.*, p. 215.

[3] Given in full, *ibid.*, pp. 251–55.

cession contracts of the banks of issue made during the régime of General Diaz were, he says, "granted in flagrant violation of our Constitution of 1857, which provided definitely that no private concern should enjoy privileges." The government, it happens, was sixty years late in discovering this flaw, but it made up for lost time by working retroactively. Also illegal, he continues, was the decree by the Huerta government, which in order to obtain a loan from the banks had granted them "the right of raising the issue from two-to-one to three-to-one, without increasing the reserve." For "that administration had come into being, not by the will of the people, but through crime and force." Furthermore, the inability of the banks on a sixty-day notice to bring the metallic reserves held against notes "into conformity with the law [which Huerta had compelled them to ignore] warranted the government [Carranza] in declaring the confiscation of their concessions." Such is the case of the government against the banks.

The Revolution was not entirely without support from Mexico's other chief source of funds. Certain foreign bankers were willing to take a speculative chance on Madero; others on Huerta. Perhaps they hoped later to pour petroleum on the troubled waters. Madero, in June, 1912, borrowed £20,000,000 from Speyer & Company, of New York. In the autumn, while still trying to preserve the domestic tranquillity, he borrowed another £20,000,000 from the same bankers.[1] By June, 1913, Huerta had assumed the rôle of pacifier at home and borrower abroad. At that time Paris bankers were willing to put £6,000,000 into the Mexican venture. This loan was secured by 38 per cent of the customs dues. Its object was to repay the loan made to Madero (whom the present borrower had overthrown), to guarantee the defaulted interest in railway bonds, to cover certain guaranties to banks and railways, to purchase the Mexican National Packing House, to provide equipment for the army, and to pay the existing deficit in the budget.[2] When the borrower appeals for additional funds it is an opportune time to make definite stipulations about various uncertainties that may have arisen touching previous contracts. The bankers in Paris did not miss this opportunity.

But Huerta's foreign-bought war equipment did not bring peace to Mexico; in the middle of 1914 he gave up the job. Civil war, with contending factions alternately occupying the Capital, continued.

[1] *Ibid.*, pp. 206 and 207.

[2] *Ibid.*, pp. 209 and 218; also Middleton, *op. cit.*, pp. 208–9.

Finally Carranza established himself and was elected president in May, 1917. He brought comparative peace, but he also brought what was regarded as a hostile attitude toward foreign investors. For it is difficult to satisfy at the same time both the propertyless voter at home and the security holder abroad. Along with Carranza came the constitution of 1917, which crystallized this attitude into the fundamental law of the land.

It is Article XXVII of the new constitution that makes most of the trouble for the foreign investor. It says, in part:

> Only Mexicans by birth or naturalization and Mexican companies have the right to acquire ownership in lands, waters, and their appurtenances, or to obtain concessions to develop mines, waters or mineral fuels in the republic of Mexico. The nation may grant the same right to foreigners, provided they agree before the Department of Foreign Affairs to be considered Mexicans in respect to such property, and accordingly not to invoke the protection of their governments in respect to the same, under penalty, in case of breach, of forfeiture to the nation of property so acquired.[1]

It is, of course, impossible to be on the side of law and order when the law contemplates such radical changes in the prevailing economic order.

When in the course of human events it becomes expedient for a people to dissolve the economic bands which have connected them with their past, a decent respect to the opinions of the investing classes requires that they should recognize all outstanding obligations. These classes, having been legally endowed with certain inalienable rights, among which are their claims to the virgin resources beneath the surface of their lands, are entitled to the protection of the law both at home and abroad. To secure these rights governments are instituted among men.

The question at issue, on the answer to which hinges the position of foreign investments in Mexico, is: How far beneath the surface of the earth does the private ownership of land extend? Who has the right to exploit the bag of gold beneath the Mexican peon? Prior to 1917 the legitimacy of the claims of the owner of the surface to all the mineral fuels of the subsoil was unquestioned. But Carranza, in February, 1918, issued a decree which apparently attempted to put into effect as to petroleum lands the provisions of the new constitution, and so to sever at a single stroke the ownership of the surface from the ownership of the petroleum deposits. In form the decree provided simply for the

[1] Middleton, *op. cit.*, p. 221, gives Article XXVII in full.

imposition of certain taxes, but to the foreign governments responsible for protecting the private property rights of their citizens in Mexico it appeared to be confiscation. The action of Carranza called forth protests from the United States, Great Britain, Holland, and France.[1] In diplomatic language:

While the United States government is not disposed to request for its citizens exemption from the payment of their ordinary and just share of the burdens of taxation so long as the tax is uniform and not discriminatory in its operation, and can fairly be considered a tax and not a confiscation or unfair imposition, and while the United States government is not inclined to interpose in behalf of its citizens in case of expropriation of private property for sound reasons of public welfare, and upon just compensation and by legal proceedings before tribunals, allowing fair and equal opportunity to be heard and giving due consideration to American rights, nevertheless the United States cannot acquiesce in any procedure ostensibly or nominally in the form of taxation or the exercise of eminent domain, but really resulting in the confiscation of private property and arbitrary deprivation of vested rights.

Carranza, in turn, expresses surprise, "as would any other government of a free country, if it found that acts of internal legislation, such as the right of imposing contributions, were called into question by diplomatic protests of the countries of subjects affected by the imposition." The law, in its majestic equality, taxes the Mexican peasants (who own no petroleum claims) as well as the foreign capitalists (who do). He continues:

The course to be taken by foreigners and nationals alike, to free themselves from impositions which are deemed confiscatory, consists in submitting the case before tribunals, which are always found ready to administer justice, applying the law, which justly guarantees individuals against confiscation of property.

When Carranza suggested this judicial way out of the difficulty he probably looked forward to appointing the judges himself. For him, however, things happened differently; and yet it was a helpful suggestion. Apparently all that is needed, legally, to make Mexico safe for foreign investors is a proper interpretation of the constitution. Article XXVII should be offset by Article XIV: "No law shall be given retroactive effect to the prejudice of any person whatsoever." The American ambassador, before presenting his credentials to the *de facto* Mexican government of 1917, received assurances that Article XIV guaranteed Americans against confiscation of their properties.[2] American

[1] For the complete diplomatic interchange see *ibid.*, pp. 229–45.

[2] *Ibid.*, p. 223.

investors are in favor of a judiciary in Mexico that will make good that promise.

Here, however, as elsewhere in matters of finance, the final appeal is to the investment bankers. Governments move slowly, watch and wait, and are limited by the conventions of diplomacy; the investment bankers act with the decisiveness and finality of those who control the sources of supply. In February, 1919, the leading American, French, and British bankers announced the organization of the International Bankers' Committee on Mexico, with Mr. J. P. Morgan as chairman. His firm issued a statement explaining that the function of the committee was to "inform itself as fully as possible as to existing conditions in Mexico with a view to such positive action as may be taken whenever circumstances permit.[1] The next time Mexico asks for funds in any of the great financial markets she will be politely referred to this Committee of Bankers. Before passing on the application, the then existing Mexican government will be requested to validate outstanding obligations in addition to making new pledges.

Good masters, what shall Mexico do that she may inherit modern industrial life? Sell whatsoever she has and give a percentage to foreign investors. There is no other way known of introducing the machine industry. Once operating under modern equipment the annual product of the country would be so large as to make its present indebtedness look small and inconsequential. The conditions under which this annual product is to be divided between the Mexican beggar and the alien investor may be stipulated in the bonds. Investors of all countries unite for the financial conquest of Mexico.

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[1] For the statement in full, with the names of the committee members, see Middleton, *op. cit.*, pp. 214–18.